

P430/D-87-198CERTIFYING 1987 DEPRECIATION ACCRUAL RATES

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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Chair
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In the Matter of United
Telephone Company of
Minnesota's Request for
Certification of 1987
Depreciation Rates

ISSUE DATE: February 12, 1988

DOCKET NO. P430/D-87-198

ORDER CERTIFYING 1987
DEPRECIATION ACCRUAL RATES

PROCEDURAL HISTORY

In April, 1987, United Telephone Company of Minnesota (United or the Company) filed with the Minnesota Public Utilities Commission (the Commission) its 1987 remaining life update to establish its 1987 depreciation accrual rates. The Company proposed that several life and salvage estimates be changed from previously-certified levels, with a resulting increase in annual depreciation expense of \$1,068,145.

The Minnesota Department of Public Service (DPS) requested additional information to clarify several of the life and salvage changes proposed. The DPS also wanted to examine any economic feasibility studies which supported the life reductions proposed for electronic digital switches in Minnesota. The Company indicated that the proposals may have been offered before any economic feasibility studies were performed. The DPS hired an engineering consultant to investigate the issue. The consultant's report was due late January, 1988. The DPS also proposed that the implementation date of the Order be set at January 1, 1987.

The DPS issued its Report of Investigation and Recommendation on December 23, 1987. United filed a Response. The DPS replied to the Company's response. On January 19, 1988, United filed a Response to the DPS Reply.

FINDINGS AND CONCLUSIONS

The Commission must determine whether the amounts of depreciation accruals agreed upon by the DPS and United are a reasonably accurate estimate of the Company's actual capital consumption in 1987 and when United's revised depreciation accrual rates are effective.

Amount of the Depreciation Accruals

Due to the delay in receiving the DPS consultant's report and the Company's desire to change its depreciation accruals as quickly as possible, the DPS and the Company tentatively agreed to certain depreciation accrual amounts.

The Commission finds that the agreement essentially corresponds with United's proposed live and salvage parameters with the following two exceptions: (1) the DPS recommended that net salvage for Account 264.13 (Heavy Trucks) remain at 15%, and; (2) the lifespan estimates for United's electronic switches remain at the levels prescribed in 1986, until the Company has an opportunity to review the DPS consultant's report. The agreement is embodied in Attachment I. ...,

The Commission finds that the agreement represents a good faith effort by the DPS and the Company. The Commission further finds that based on the information available at this time the amounts agreed upon are a reasonably accurate estimate of the Company's actual capital consumption in 1987.

The Commission concludes that it will approve the amount of depreciation accruals agreed to by the parties, pending further Commission action after receipt of the DPS consultant's report. The Commission may use the report as a basis for represeting the depreciation accrual rates approved here before United's next 5 year study is filed in 1992. The Commission will order the DPS to report on the results of the consultant's investigation of United's electronic switches within 30 days of its receipt.

Effective Date of Depreciation Accrual Rates

United asked that the accrual rates be made effective prospectively, from the first day of the month following this Order. United argued that prospective application of the newly certified depreciation rates is required under Minn. Rules, part 7810.8000. Further the Company argued that the purpose of depreciation accounting is capital recovery. United maintained that if prospective application of the depreciation rates were denied in this case it would be unable to recover expenses properly attributable to ratepayers in providing service to them.

The DPS argued that the effective date should be January 1, 1987. The Department maintained that the purpose of depreciation is to account for a loss in service value, regardless of whether that loss is recovered. The DPS argued that depreciation accruals should coincide with the period during which the capital consumption occurs. The DPS noted that

in this case, where there is an increase in depreciation accruals, the effective date must reflect the period during which the capital consumption occurred. Otherwise, continuing previous accruals will understate the Company's Depreciation Reserve and overstate its rate base.

Minn. Stat. Section 237.22 (1986) charges the Commission with fixing proper and adequate rates and methods of depreciation.

Minn. Rules, parts 7810.7000 to 7810.8000 which address telephone company depreciation filings and practices aid the Commission in meeting its obligations under the statute. The Commission finds that those rules must be interpreted to further its legislative mandate.

The Commission finds that its longstanding interpretation of Minn. Rules, part 7810.8000 makes the effective date of the newly certified depreciation accrual rates the beginning of the calendar year to which the newly approved rates will apply. See, United, Docket No. P430/D-85-265 (October 9, 1985); United, Docket No. P430/D-86-194 (December 17, 1986); Northern States Power Company, Docket No. E002/D-86-603 (December 9, 1986). This approach to setting the effective date is consistent with both the purpose of depreciation and the standard accounting practices for recording depreciation. The Commission continues to find that this is reasonable because depreciation accounting is a method to measure and recognize the loss in service value of an asset over time.

The Commission finds that the American Institute of Certified Public Accountants' definition of depreciation accounting supports its position. This states:

Depreciation accounting is a system of accounting which aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not of valuation.

(Emphasis supplied.) Acctg. Term Bull. No. 1, Paragraph 56 (August, 1953)

Further, the Commission finds that the National Association of Regulatory Utility Commissioners. (NARUC) definition also supports the above finding:

"Depreciation" as applied to depreciable utility plant, means the loss in service value not restored by current maintenance, incurred in connection with the

consumption or prospective retirement of utility plant in the course of service from causes which are known to be in current operation and against which the utility is not protected by insurance. Among the causes to be given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand, and requirements of public authorities. (Emphasis supplied.) Public Utilities Depreciation Practices, NARUC, May, 1974, p. 17.

The Commission finds that United's contention that depreciation accounting is a method of capital recovery should be rejected. The Commission notes that when the Company filed these depreciation rates, it must have believed that they were accurate. As they are considerably higher than the depreciation rates previously certified, the Commission finds that the Company at all times had the option of filing a general rate case to achieve capital recovery. The Company cannot now argue that depreciation accounting methods should be ordered to achieve capital recovery. Pursuant to Minn. Stat. Section 237.22 (1986), the Commission concludes that depreciation accruals should coincide with the time period during which the capital consumption occurs to insure that the Company's accounting records accurately reflect United's financial status. The Commission will order that United's new depreciation rates are effective January 1, 1987.

The Commission finds that United's argument fails to give account to the Company's responsibilities and actions in seeking new depreciation rates. The Commission's rules place the prime responsibility upon the telephone company to propose new depreciation rates. Minn. Rules, part 7810.7000. The telephone company must review its rates annually to determine if the rates continue to be appropriate and must submit a full study at least every five years. Minn. Rules, part 7810.7500. Minn. Rules, part 7810.8000 primarily puts the obligation upon the telephone company to petition for certification of its depreciation rates and methods. This case is based upon United's five year study due for the year 1987.

Although United filed its petition in accord with these rules and sought new rates for 1987, it did not file its petition until April 1987. United's choice of when to file its petition proposing rates for 1987 is inconsistent with its claim that the rates would apply prospectively only from the date of the Commission's order. Because United was obligated to file a new five year study beginning in 1987, if it had wanted new rates for 1987 that would apply only prospectively from the Commission order, it should have filed a petition sufficiently in advance of January 1, 1987, to permit review and approval prior to that date. By filing in April 1987, United absolutely prevented the Commission from issuing an order setting an effective date for 1987 rates on the basis United now claims. Even United apparently did not believe until recently that the rule works as it now claims.

Moreover, the rule language relied upon by United does not establish the effective date for depreciation rates but rather acts merely as an issue resolution device for rate making proceedings. Fixing depreciation rates adjusts an accounting practice and does not change the price charged to telephone customers. In order to change the prices charged to customers, the telephone company must follow specific procedures found in statute. See Minn Stat. § 237.075 (1986). The effects of the company's accounting practices upon the price change would depend upon many other factors offered as proof in support of the price change. The separate nature of depreciation rate and price rate cases is demonstrated by the fact that the rule does not address its effect upon pending price

change cases, which must be determined by the circumstances of the depreciation petition and the relationship of the new depreciation rates to the other facts in the record of the price rate case.

Also, United misstates the retroactive applicability of the new depreciation rates. United had not closed its books for 1987 at the time this matter came before the Commission. Because final depreciation amounts are recorded at the time the books for the year are closed, setting new depreciation rates does not conflict with United's year end accounting procedure. Annual depreciation amounts recorded on the company's books also reflect additions and retirement of assets made during the year. Therefore, setting rates prior to closing a company's books cannot be interpreted as being retroactive. In fact, current year asset changes (additions and retirements can affect the rates that are set for the year and it is prudent to set rates with current information. Thus, this should not be confused with the prohibited practice of retroactive ratemaking when prices to customers are involved.

The certification by the Commission as to the methods of life estimation, methods of accrual determination, estimated service lives, estimated net salvage percentages of gross plant, specific dollar amounts to be amortized, specific dollar amounts to be allowed as Additional Depreciation or percentage accrual rates does not necessarily imply that the specific dollar amounts of gross plant, depreciation reserve, annual accrual and dollars to be amortized or allowed as Additional Depreciation will be immune from audit at rate case time for ratemaking purposes; nor does this Order imply that all items in the various plant accounts will be considered proper to be included in the rate base at rate case time for ratemaking purposes.

The Commission will order United to file its next 5-year study by April 1, 1992 and its next remaining life update by April 15, 1988.

ORDER

1. The Commission hereby approves the amount of depreciation accruals agreed upon by the DPS and United represented in Attachment I and incorporated in this Order, effective January 1, 1987.
2. The DPS shall file with the Commission a report on the results of its consultant's investigation of United's electronic switches within 30 days of its receipt. The report may be used to modify the depreciation rates set here prior to the filing of United's next 5-year study.
3. United shall file its next 5-year study by April 1, 1992 and its next remaining life update by April 15, 1988.
4. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Mary Ellen Hennen
Executive Secretary

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